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SEC

SERVICE DATE – OCTOBER 24, 2007

SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 664

METHODOLOGY TO BE EMPLOYED IN DETERMINING THE RAILROAD INDUSTRY'S
COST OF CAPITAL

AGENCY: Surface Transportation Board.

ACTION: Notice of Public Hearing.

SUMMARY: The Surface Transportation Board will hold a public hearing beginning at 10:00 a.m. on Tuesday, December 4, 2007, at its offices in Washington, DC. The purpose of the hearing will be to allow current parties of record to comment on the proposed methodology to be employed in determining the railroad industry's estimated cost of capital and the record developed in this proceeding. Parties of record wishing to speak at the hearing should notify the Board in writing.

DATES: The public hearing will take place on Tuesday, December 4, 2007. Any party of record wishing to speak at the hearing should file with the Board a written notice of intent to participate, and should identify the party, the proposed speaker, the time requested, and the topic(s) to be covered, as soon as possible but no later than November 20, 2007. Each speaker should also file with the Board his/her written testimony by November 27, 2007.

ADDRESSES: All notices of intent to participate and testimony may be submitted either via the Board's e-filing format or in the traditional paper format. Any person using e-filing should attach a document and otherwise comply with the Board's "www.stb.dot.gov" website, at the "E-FILING" link. Any person submitting a filing in the traditional paper format should send an original and 10 copies of the filing to: Surface Transportation Board, Attn: STB Ex Parte No. 664, 395 E Street, SW, Washington, DC 20423-0001.

FOR FURTHER INFORMATION, CONTACT: Timothy Strafford, (202) 245-0356.
[Assistance for the hearing impaired is available through the Federal Information Relay Service (FIRS) at: (800) 877-8339.]

SUPPLEMENTARY INFORMATION: Each year the Surface Transportation Board (Board) determines the railroad industry's cost of capital. The Board then uses this cost of capital figure for a variety of regulatory purposes. It is used to evaluate the adequacy of individual railroads' revenues each year. It is also employed in maximum rate cases, feeder line applications, rail line abandonments, and trackage rights cases.

The Board calculates the cost of capital as the weighted average of the cost of debt and the cost of equity, with the weights determined by the capital structure (the fraction of capital from debt or equity on a market-value basis) of the railroad industry. While the cost of debt is observable and readily available, the cost of equity (the expected return that equity investors require) can only be estimated. How best to calculate the cost of equity is the subject of a vast amount of literature covering the fields of finance, economics, and regulation. In each case, however, because the cost of equity cannot be directly observed, estimating the cost of equity requires adopting a financial model and making a variety of simplifying assumptions. The Board currently uses a Discounted Cash Flow (DCF) methodology to calculate the cost of equity, which in turn is used to calculate the cost of capital.

By advance notice of proposed rulemaking served on September 20, 2006, the Board sought comments on the appropriate methodology to be employed in determining the cost of equity component of the cost of capital. On February 15, 2007, the Board held a hearing on the Board's cost-of-capital calculation, and how this evidence should be submitted and analyzed in future proceedings. On August 14, 2007, the Board proposed to move from a DCF method to a Capital Asset Pricing Model (CAPM) method in determining the estimated cost of capital. Generally, CAPM first determines the return an investor would receive on a risk-free investment. An estimate of the risk premium associated with the particular investment is then developed. Once the risk premium is quantified, its value is added to the risk-free investment rate to obtain an estimate of the cost of equity.

In the August 14, 2007 decision, the Board invited comments on the proposed methodology. A number of parties have commented on the importance of this proceeding and the Association of American Railroads requested that the Board hold a hearing to discuss the proposed changes to the cost of capital calculation. This hearing should be a forum for parties to provide views and information about the Board's proposed changes and the record developed in this proceeding. The Board invites information and comments on the proposed CAPM methodology to calculate the rail industry's cost of capital.

Date of Hearing. The hearing will begin at 10:00 a.m. on Tuesday, December 4, 2007, in the hearing room at the Board's headquarters in Washington, DC, and will continue, with short breaks if necessary, until every person scheduled to speak has been heard.

Notice of Intent To Participate. Any party of record wishing to speak at the hearing should file with the Board a written notice of intent to participate, and should identify the party, the proposed speaker, the time requested, and topic(s) to be covered, as soon as possible, but no later than November 20, 2007.

Testimony. Each speaker should file with the Board a copy of his/her written testimony by November 27, 2007.

Board Releases and Live Audio Available Via the Internet. Decisions and notices of the Board, including this notice, are available on the Board's website at "www.stb.dot.gov." This hearing will be available on the Board's website by live audio streaming. To access the hearing,

click on the “Live Audio” link under “Information Center” at the left side of the home page beginning at 10:00 a.m. on Tuesday, December 4, 2007.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

Dated: October 24, 2007.

Vernon A. Williams
Secretary